



Number 07-107  
November 9, 2007

**ATTENTION:** CHIEF COMPLIANCE OFFICER, CHIEF TECHNOLOGY OFFICER

**TO:** ALL MEMBER ORGANIZATIONS

**SUBJECT:** NYSE RULE 92 - CUSTOMER CONSENT AND FREQUENTLY ASKED QUESTIONS

## I. Purpose

The purpose of this Information Memo is: (i) to provide additional guidance with respect to the recent amendment to NYSE Rule 92(b), which permits obtaining blanket consent to trade along with a customer's order, but does not prevent a member organization from obtaining customer consent under Rule 92(b) on an order-by-order basis using the pre-amendment express consent procedures, and (ii) to answer frequently asked questions about amended Rule 92. The NYSE has filed this Information Memo with the SEC for immediate effectiveness.<sup>1</sup>

## II. Background

NYSE Rule 92 generally prohibits members or member organizations from trading on a principal or proprietary (for purposes of this memo, "proprietary") basis ahead of customer orders that are executable at the same price as the proprietary order. Among other provisions, the rule contains several exceptions that make it permissible for a member or member organization to enter a proprietary order while representing a customer order that could be executed at the same price, so long as the member organization has made periodic written disclosures and obtains and documents affirmative customer consent ("Rule 92(b) proprietary order").<sup>2</sup>

Rule 92 was amended on July 5, 2007 to add the requirement described above. Under the prior version of the rule, members and member organizations needed to obtain order-by-order consent from customers before they could execute a Rule 92(b) proprietary order ahead of or along with a customer's order. The rule provided that a member organization could trade along if "the customer has given express permission, including an understanding of the relative price

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<sup>1</sup> See Securities Exchange Act Release No. 34-56753 (Nov. 6, 2007), SR-NYSE-2007-97.

<sup>2</sup> These are transactions in which the member or member organization is: (1) liquidating a position held in a proprietary facilitation account; (2) creating a bona fide hedge; (3) modifying an existing hedge; or (4) engaging in a bona fide arbitrage or risk arbitrage transaction.

and size of allocated execution reports” (hereinafter referred to as “express consent procedure”). In 2001, in connection with the express consent procedure, the NYSE issued the following guidance:

A customer whose order is being traded along with must have given express permission for the member or member organization to trade along. The consent requirement applies to both domestic [and] foreign customers. The express permission of the customer must include an understanding by the customer of the relative price and size of the allocated execution reports. Such permission must be obtained on an order-by-order basis.

Although the [2001] amended rule does not outline a specific method of record keeping evidencing that a customer has given permission to trade along, members and member organizations must implement appropriate procedures to capture this information with respect to each such order. The burden of proof to demonstrate that customer consent was obtained will fall on the member organization.

See Information Memo 01-21 (Aug. 9, 2001) and Information Memo 01-33 (Oct. 8, 2001) (the “2001 guidance”).

As amended in 2007, the method for obtaining customer consent was expanded to include an affirmative blanket consent procedure. However, the 2007 amendment did not prohibit, and was not intended to prohibit, the use of the express consent procedure for obtaining trade-along approval in a given instance.

### **III. “Express Permission” under Rule 92(b) still permitted**

NYSE Regulation is issuing this Information Memo to clarify that under Rule 92(b), in addition to affirmative consent procedure, a member organization may still use the express consent procedure for obtaining consent from a customer to trade along on an order-by-order basis with a Rule 92(b) proprietary order. Accordingly, if a customer does not want to provide blanket affirmative consent, a member organization may still obtain consent on an order-by-order basis to trade along with an order from that customer.

Subject to clarifications discussed in this Information Memo, the 2001 guidance discussed above that the NYSE issued in connection with Rule 92(b), i.e., Information Memos 01-21 and 01-33, still governs the process that firms must follow when obtaining consent from customers under the express consent procedures.<sup>3</sup>

Although the 2001 guidance did not dictate how member organizations should maintain records evidencing that a customer has given permission to trade along, a recent NYSE Regulation Hearing Panel decision has interpreted the Rule 92(b) record-keeping requirements to require that member organizations record not only the percentage split of a trade along order, but also the customer contact name that provided such consent.<sup>4</sup> NYSE Regulation believes that this information is necessary for ensuring that member organizations properly document when a customer has provided consent under Rule 92(b).

Accordingly, member organizations are advised that when following express consent procedures, they must document not only the relative price and size of the allocated order, i.e.,

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<sup>3</sup> Because amended Rule 92(b) now permits blanket affirmative consent, the statement in the 2001 guidance prohibiting a broad contractual understanding of consent is no longer applicable.

<sup>4</sup> See In re Merrill Lynch, Pierce, Fenner & Smith Incorporated, NYSE Hearing Board Decision 07-005 (Jan 12, 2007) ( firm failed to adhere to principles of good business practice because it did not record both the customer contact name and the percentage split when documenting whether a customer provided trade-along consent).

the percentage split with the customer, but also the identity of the person at the customer who approved the trade-along request. As with the affirmative consent procedure, the identity of the person must be noted in a manner that will permit subsequent contact with that person if a question as to the consent arises (i.e., first names only, initials, and nicknames will not suffice).

Previously, the NYSE Regulation has found that a firm's failure to take reasonable measures to satisfy the burden of proving customer consent violated NYSE Rule 401 in that the firm did not conduct its business in accordance with principles of good business practice. Member organizations are advised that NYSE Regulation considers such conduct to violate not only NYSE Rule 401 but NYSE Rule 92 as well, if it occurs after the date of this memorandum.

#### **IV. Frequently-Asked Questions**

NYSE Regulation has received a number of inquiries from member organizations regarding the scope and application of amended NYSE Rule 92(b). The following questions and answers address key themes and issues that have been raised to the NYSE Regulation staff regarding the rule and the amendment.

**Q1:** What class of investors may provide consent under Rule 92(b)?

**A1:** NYSE Rule 92(b) permits institutional investors with orders of any size, or individual investors with an order over 10,000 shares, unless such orders are less than \$100,000 in value, to consent to a member organization entering Rule 92(b) proprietary orders. Member organizations should note that Information Memo 07-87 contains a typographical error and refers to orders of less than \$10,000 in value. This is incorrect; in fact, Rule 92(b) specifically refers to customers with orders "over 10,000 shares, unless such orders are less than \$100,000 in value."

**Q2:** May a firm use web-based disclosures to satisfy its Rule 92(b) and 92(c) disclosure requirements?

**A2:** NYSE Regulation expects member organizations to engage in proactive measures to ensure that customers actually receive and have an opportunity to review the Rule 92(b) and 92(c) disclosures. As a result, web-based disclosures generally by themselves (e.g., a notation on a customer trade confirmation directing a customer to visit the firm's website to read disclosures) do not satisfy the Rule 92(b) or 92(c) disclosure requirements, since there is no way to confirm that the customer actually reviewed the disclosures before providing consent. Notwithstanding this, a web-based disclosure could be appropriate if it is meaningful and well documented. For example, an appropriate disclosure procedure could be if member organizations refer customers to a web-based disclosure, review the terms of such disclosure orally with the customer before obtaining consent, and then create a record to demonstrate that the customer received this meaningful disclosure. Similarly, a web-based disclosure that requires the customer to click through the disclosures before providing consent could also be appropriate, assuming that the firm maintains documentation demonstrating that the particular customer availed itself of the click-through procedure. In either case, the member organization must be able to demonstrate through specific records that the customer actually accessed and had an opportunity to review the disclosures before providing consent.

**Q3:** If a firm did not obtain documentation relating to affirmative consent under Rule 92(b) by September 30, 2007, may it still obtain affirmative consent from customers?

**A3:** Yes. The purpose of the September 30, 2007 deadline was to provide member organizations with a grace period to make the written disclosures required under amended Rule 92. The SEC approved the three-month grace period so that immediately upon approval of the amended rule, firms that wanted to use the new process for obtaining blanket consent from customers to trade along could do so even before their written disclosures were finalized, so long as the process of making written disclosures and documenting the orally-provided consents

was completed by September 30. Because the grace period has expired, member organizations must provide written disclosures to their customers and document the customers' affirmative consents before they may trade along with such customers.

**Q4:** Can a customer provide blanket affirmative consent to percentage split allocations that are variable depending on the specifics of a particular trade?

**A4:** No. Before obtaining affirmative consent under Rule 92(b), member organizations must disclose the method by which the member organization will allocate shares to the customer's order. If either the customer or the member organization chooses to alter such allocation methodology, including changing the agreed-upon percentage split, the member organization would need to follow the express consent procedures on an order-by-order basis to document what the percentage split would be and the customer contact name that consented to that split.

#### **IV. Supervision**

Member organizations are reminded that they must have adequate written policies, procedures, and supervisory controls reasonably designed to detect and deter potential violations of the rule as described in this Memorandum. Failure to have adequate written policies and procedures in place or to have an adequate supervisory system in place may result in disciplinary action.

#### **V. Staff Contacts**

Questions regarding NYSE Rule 92 may be directed to:

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